

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF RATES OF ERI-GEK SEWER)
TREATMENT PLANT UNDER KAR 5:076)
ALTERNATIVE RATE ADJUSTMENT PROCEDURE)
FOR SMALL UTILITIES)

CASE NO.
8649

ORDER

On September 16, 1982, Eri-Gek Sewer Treatment Plant ("Eri-Gek") filed an application with the Commission to increase its sewer rates pursuant to 807 KAR 5:076. This regulation allows utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative filing method to minimize the necessity for formal hearings, to reduce filing requirements, and to shorten the time between the application and the Commission's final Order. Eri-Gek requested rates to produce an annual increase of \$15,675.

On October 13, 1982, a motion to intervene was filed by Garey D. Higdon and Half Moon Apartment Partnership ("Half Moon"). This motion was granted by the Commission. On January 5, 1983, Half Moon filed a motion for a formal hearing, which was also granted by the Commission. A hearing was held on February 22, 1983, at the Commission's offices in Frankfort, Kentucky. At this hearing Eri-Gek submitted a revised request decreasing its proposed increase to \$10,929. A second hearing regarding the revised request was held on March 17, 1983. At this hearing,

Eri-Gek submitted additional revisions to reflect rates based on plant design criteria rather than a flat rate as originally proposed. According to Eri-Gek these new rates would produce annual revenues of \$50,954, an increase of \$10,792 over test period revenues of \$40,162. In this Order the Commission has allowed an increase of \$7,000.

TEST PERIOD

Eri-Gek submitted financial exhibits for the 12 months ending June 30, 1982. Pursuant to 807 KAR 5:076 the most recent calendar year's Annual Report on file with the Commission is the standard financial test period upon which the Commission bases its determination. However, the Commission has accepted the 12 months ending June 30, 1982, as the test period in this matter because the exhibits filed are in order and are representative of current operating conditions.

VALUATION METHOD

Eri-Gek proposed and the Commission has accepted the operating ratio method as the basis for determining revenue requirements in this matter. The Commission has used this method in determining revenue requirements for most sewer utilities under its jurisdiction for the past several years and finds the results have been reasonable and fair to both utilities and ratepayers. Therefore, the Commission, after consideration of various methods, will use the operating ratio method calculated as follows:

$$\text{Operating Ratio} = \frac{\text{Operating Expenses} + \text{Depreciation} + \text{Taxes}}{\text{Gross Revenues}}$$

REVENUES AND EXPENSES

Eri-Gek had net operating income of \$3,155 for the test period. In order to reflect current operating conditions, Eri-Gek proposed numerous adjustments to expenses resulting in adjusted net operating income of \$1,957. The appropriate level of net operating income as determined by the Commission is \$3,233.

The Commission has accepted Eri-Gek's pro forma revenues and expenses with the following adjustments:

Excess Capacity

In response to an information request ^{1/} Eri-Gek stated that the capacity of the system is 200,000 Gallons Per Day ("GPD"). At the February 22, 1983, hearing Eri-Gek presented testimony that the present maximum demand level on the system is 165,000 to 175,000 GPD. ^{2/} In testimony presented at the March 17, 1983, hearing, Eri-Gek filed a statement which showed that based on the design criteria of the Louisville and Jefferson County Department of Public Health Eri-Gek's capacity should be 169,400 GPD. Because the amount over and above the 169,400 GPD specified by the design criteria is not presently required, and in fairness to all parties concerned, the Commission is of the opinion that the costs associated with this excess capacity should be shared equally by the owners and the ratepayers. Accordingly, the Commission has reduced Eri-Gek's operating expenses by \$900. ^{3/}

Rate Case Expense

The level of rate case expense incurred herein is far in excess of the amount considered reasonable by this Commission for a rate case of this complexity. The Commission will accept the actual costs incurred of \$7,123 amortized over 3 years because of the number of hearings held in this case (an annual cost of \$2,374 and a reduction of Eri-Gek's proposed operating expenses of \$376) but advises Eri-Gek that future rate case expenses should be kept much below the level accepted herein, and that failure to adhere to this advice could result in the disallowance of a large portion of these expenses.

Interest Expense

Eri-Gek proposed to increase expenses by \$1,558 for interest due on a note payable of \$17,315 at a 9 percent annual interest rate. In response to an information request, ^{4/} Eri-Gek stated that no note and no interest terms existed and that the funds in question were actually loans from the owners of Eri-Gek, which were used to pay ongoing operating expenses. Because these loans from the owners are in effect equity capital, which is compensated through the operating ratio, and moreover, because the rates granted herein should provide sufficient revenues to pay ongoing operating expenses, the Commission has disallowed this adjustment.

Therefore, Eri-Gek's test period operations are adjusted as follows:

	<u>Eri-Gek Proposed</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$40,162	\$ -0-	\$ 40,162
Operating Expenses	<u>38,205</u>	<u>(1,276)</u>	<u>36,929</u>
Net Operating Income	1,957	1,276	3,233
Interest Expense	<u>6,755</u>	<u>(1,558)</u>	<u>5,197</u>
Net Income	<u>\$(4,798)</u>	<u>\$ 2,834</u>	<u>\$ (1,964)</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that a fair, just and reasonable operating ratio is 88 percent in that it will permit Eri-Gek to pay its operating expenses, service its debt and provide a reasonable return to its owners. Therefore, the Commission is of the opinion that Eri-Gek is entitled to increase its rates to produce total revenues of \$47,162 ^{5/} for an increase in revenues of \$7,000.

RATE DESIGN

Eri-Gek proposed to revise the rate structure from a 2-customer classification flat rate design to a 7-customer classification flat rate design based upon plant design criteria. The present rate structure needs revision because of the different types of customers receiving service. However, the use of plant design criteria is not the most equitable method of revising the rate structure in this case. While the use of plant design criteria is a valid and useful tool to estimate the projected usage by typical customers when designing a treatment plant, it is at best an estimate and should be relied upon when actual usage records are not available. Actual usage records are available for the various addresses served by Eri-Gek.^{6/} Therefore, the 7-customer classification flat rate design rate structure in Appendix A is based upon actual usage records in conjunction with

the plant design criteria submitted. The small commercial, YMCA and residential rates are based entirely on actual usage while the 1, 2, and 3 bedroom apartment, condominium, laundry facility and swimming pool rates are based on the total actual usage by these customers prorated among the various classifications of customers using plant design criteria.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates proposed by Eri-Gek are unfair, unjust and unreasonable in that they would produce revenues in excess of those found reasonable herein and should be denied.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for sewage service rendered by Eri-Gek in that they will permit Eri-Gek to meet its operating expenses and provide a reasonable return to its owners.


IT IS THEREFORE ORDERED that the rates proposed by Eri-Gek be and they hereby are denied.

IT IS FURTHER ORDERED that the rates in Appendix A are the fair, just and reasonable rates for Eri-Gek Sewer Treatment Plant to charge for sewage service and are hereby approved for service rendered on and after the date of this Order.

IT IS FURTHER ORDERED that Eri-Gek shall file with this Commission within 30 days of the date of this Order its tariff sheets setting forth the rates approved herein.

Done at Frankfort, Kentucky, this 23rd day of May, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

FOOTNOTES

1/ Response filed 11/10/82, item 5.

2/ Testimony of Albert Altieri, February 22, 1983, page 51.

<u>3/</u>	<u>Book Amount</u>	<u>Excess Capacity*</u>	<u>Adjustment</u>
Depreciation	\$ 6,071	.0765	\$464
Property Taxes	504	.0765	39
Interest	5,197	.0765	397
	<u>\$11,772</u>		<u>\$900</u>

*200,000 GPD - 169,400 GPD = 30,600 GPD ÷ 200,000 GPD =
.153 ÷ 2 = .0765.

4/ Response filed 11/10/82, item 8.

5/ \$36,929 (Operating Expenses) ÷ .88 = \$41,965 + 5,197
(Interest Expense) = \$47,162.

6/ Response filed 12/1/82, Exhibit VI.

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 8649 DATED MAY 23, 1983

The following rates are prescribed for all customers served by Eri-Gek Sewer Treatment Plant. All other rates and charges not specifically mentioned herein shall remain the same as those in effect prior to the date of this Order.

<u>CLASSIFICATION:</u>	<u>MONTHLY RATE</u>
1 Bedroom Apartments	\$ 5.35
2 Bedroom Apartments	7.50
3 Bedroom Apartments, all Condominiums and Single Family Residential	9.20
Small Commercial	28.00
Laundry Facilities	28.00
YMCA	200.00
Swimming Pools	25.00